IT IS ORDERED as set forth below:

Date: March 31, 2015

Barbara Ellis-Monro
U.S. Bankruptcy Court Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

IN RE:	
International BioChemical Industries, Inc., f/d/b/a BioShield Technologies, Inc.,	CASE NO. 04-92814-BEM
Debtor.	CHAPTER 7
Herbert C. Broadfoot, II, as Chapter 7 Trustee for International BioChemical Industries, Inc., f/d/b/a BioShield Technologies, Inc.,	
Movant,	
v.	Contested Matter
Jamestown Management Corporation, as Managing Agent for Cologne Investors, Inc. & Irving Walter Graebner,	
Respondent.	

O R D E R

This case came before the Court on the Jamestown Management Corporation's second amended proof of claim [Claim 12-2] and the Chapter 7 Trustee's "Objection to Further

Claims of Jamestown Management Corporation, as Managing Agent for Cologne Investors, Inc. & Irvin Walter Graebner" (the "Objection") [Doc. No. 188], the "Response of Jamestown Management Corporation, as Managing Agent, to Trustee's Further Objection to Jamestown's Second Amended Proof of Claim" [Doc. No. 189], and the Trustee's "Reply to Response of Jamestown Management Corporation, as Managing Agent to Trustee's Further Objection to Claimant's Further Amended Claim" [Doc. No. 190]. The Court has jurisdiction over this matter pursuant to 28 U.S.C. § 158(b)(2)(B). The Court held a hearing on the Objection on December 17, 2014. Having considered the facts and legal arguments presented by the parties, the Court will sustain, in part, the Objection and allow Jamestown's claim in the total amount of $1,034,674.20.

FINDINGS OF FACTS

The facts of this case are fully set forth in the Court's order of October 6, 2014 (the "October 6 Order"), *Broadfoot v. Jamestown Mgmt. Corp*. (*In re International BioChemical Indus., Inc.*), 521 B.R. 395 (Bankr. N.D. Ga. 2014). In summary, in July 1999, Debtor entered into a 10-year lease (the "Lease") of real property ("the Property") with Jamestown. *Id.* at 397. The Lease provided that in the event of a default by Debtor, Jamestown could retake the Property without terminating the Lease. *Id.* In December 2000, Debtor vacated the Property and stopped making lease payments, and Jamestown initiated a dispossessory action in state court. *Id.* On January 19, 2001, Jamestown received a default judgment and was awarded a writ of possession and damages in the amount of $151,706.10 for unpaid rent for December 2000 and January 2001 (the "2001 Judgment"). *Id*. In December 2001, after failing to find a new tenant for the Property, Jamestown initiated a second lawsuit in which it received a summary judgment and, after appeal,

was awarded a final judgment of $3,109,099.76 on October 31, 2003 (the "2003 Judgment"). *Id*. The 2003 Judgment included damages for unpaid rent from February 2001 to October 2003. *Id*.

Debtor filed its bankruptcy petition on January 17, 2004. *Id*. Jamestown asserted an amended claim in the amount of $3,309,910.58 based on the 2001 and 2003 Judgments. *Id*. at 398. The Chapter 7 Trustee objected to the claim, arguing in part that it should be reduced in accordance with 11 U.S.C. § 502(b)(6), which imposes a cap on claims resulting from termination of a lease. *Id*. at 399. Jamestown argued that the lease cap did not apply to its claim because the Lease had not terminated at the time of the 2003 Judgment and no part of its claim included damages resulting from termination of the Lease. *Id*. at 400.

In the October 6 Order, the Court held that the Lease *de facto* terminated for purposes of § 502(b)(6) when Jamestown obtained a writ of possession on January 19, 2001, even if it had not yet terminated under its terms and nonbankruptcy law. *Id*. at 403. The Court further held that January 19, 2001, was also the earlier of the petition date and the date of surrender or repossession of the Property for purposes of § 502(b)(6)(A). *Id*. at 403-04. Thus, any damages arising after January 19, 2001, were lease termination damages, subject to the cap. *Id*. at 404. The Court ordered Jamestown to amend its claim accordingly. *Id*.

Jamestown filed an amended claim on November 3, 2014, in the amount of $2,057,121.08 [Claim 12-2]. The claim includes the full amount of the 2001 Judgment, plus post-judgment interest on the 2001 Judgment through the petition date. All amounts relating to the 2001 Judgment are uncapped. The claim also includes amounts awarded under the 2003 Judgment. The amount of the 2003 Judgment, including rent, operating expenses, late fees, and taxes, is capped. In addition, the claim includes contract and post-judgment interest, attorney's

fees, and post-judgment interest on attorney fees through the petition date, all of which are uncapped.

One new fact has come to light since the October 6 Order. At the December 17, 2014 hearing on the Objection, counsel for the Trustee advised the Court that he had learned one day earlier that Jamestown sold the Property on October 22, 2003—nine days before entry of the 2003 Judgment. [Doc. 190, Trustee's Reply, Exhibit A]. The Trustee further asserted that the sale documents make no mention or reservation of the Lease, and it is not listed as a permitted title exception. Counsel for Jamestown acknowledged the sale but stated that he had also first learned of it one day prior to the hearing. Counsel for Jamestown stated there was no question the Lease terminated when the Property was sold not subject to the Lease. Counsel for Jamestown further stated that Jamestown would accept October 2003 as the termination date under state law.

The Trustee objected to the amended claim on the grounds that (1) it includes late fees, interest, and attorney's fees, which should be disallowed; (2) it does not provide the correct amount of, and support for, rent due as of January 19, 2001, in that it fails to account for prepetition payments made by Debtor; and (3) it fails to properly calculate the rent reserved by the Lease. The Trustee contends that the allowed amount of the claim should not exceed $1,227,587.11. Jamestown contends that the Court erred in the October 6 Order and asks the Court to reconsider its ruling that the Lease terminated on January 19, 2001. Jamestown contends further that none of the amounts claimed result from termination of the Lease and, therefore, the claim should not be capped and the 2001 and 2003 Judgments are preclusive as to the amount of Jamestown's claim. In the alternative, Jamestown argues that the cap does not apply to its post-judgment interest and attorney's fees, and that any amounts paid by Debtor toward the pre-

termination unpaid rent constitute mitigation, which does not reduce the amount of the capped claim.

CONCLUSIONS OF LAW

I. Date of Lease Termination for Purposes of § 502(b)(6)

Under § 502(b)(6), in the event an objection to a proof of claim is filed, the claim is allowed:

> except to the extent that—
> …
> (6) if such claim is the claim of a lessor for damages *resulting from the termination* of a lease of real property, such claim exceeds—
> (A) the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease, following the earlier of—
> (i) the date of the filing of the petition; and
> (ii) the date on which such lessor repossessed, or the lessee surrendered, the leased property; plus
> (B) any unpaid rent due under such lease, without acceleration, on the earlier of such dates[.]

11 U.S.C. § 502(b)(6) (emphasis added).[1] Jamestown contends that its entire claim consists of damages that arose prior to termination of the Lease and that because none of the claim results from termination of the Lease, § 502(b)(6) does not apply to the claim. Jamestown urges the Court to reconsider its prior ruling that the term "termination" in § 502(b)(6) is defined by bankruptcy law rather than state law. Based on statements of Jamestown's counsel at the December 17, 2014 hearing, Jamestown apparently concedes that the Lease terminated under nonbankruptcy law when the Property was sold on October 22, 2003. The Court agrees that under state law and the terms of the Lease, the Lease terminated no earlier than October 22,

[1] As explained in the October 6 Order, the Trustee bears the burden to prove § 502(b)(6) applies to Jamestown's claim. Once he does so, the burden shifts to Jamestown to prove the extent to which the claim is allowable. 521 B.R. at 399 n.2.

2003. However, after consideration of Jamestown's arguments, the Court declines to revisit its prior ruling regarding the definition of "termination."

In addition to the reasons already set forth in the October 6 Order, if Jamestown is correct that § 502(b)(6) refers to termination as defined by nonbankruptcy law, then § 502(b)(6) would not apply to leases that are rejected under 11 U.S.C. § 365 unless rejection also resulted in termination of the lease under nonbankruptcy law.

> Indeed, section 365 uses the terms "rejection," "breach" and "termination" differently. Thus, "rejection" is the decision of the trustee or the debtor, as the case may be, not to assume a burdensome contract or lease. "Rejection" constitutes a "breach" pursuant to section 365(g), except to the extent that a contract or lease is "terminated" pursuant to section 365(h) or (i). Subsections (h) and (i) authorize lessees of real property, timeshare purchasers or buyers of real property to remain in possession of the property after rejection by a lessor or seller or, alternatively, to treat the lease or sale agreement as "terminated" by the rejection. Other than the option given to lessees and purchasers to treat rejection as termination, section 365 does not explicitly provide for termination of a party's or lessee's contract interests. Moreover, if rejection of the lease worked a termination, it would be difficult to justify granting the other party to the contract or lease a damage claim for rejection, which the lessor is given by section 502(g). Similarly, because a rejection constitutes only a breach, not a termination, a covenant not to compete in a rejected contract continues to bind the debtor, unless the obligation is discharged.

3 Collier on Bankruptcy ¶ 365.10 (16th ed. 2010). Notwithstanding the fact that rejection amounts only to a breach and not termination of an unexpired lease, courts often apply § 502(b)(6) to rejection claims by equating rejection and termination. *See In re Rhodes*, 321 B.R. 80, 84 (Bankr. N.D. Ga. 2005) (Massey, J.) (citing, 4 Collier on Bankruptcy ¶ 502.03[7][b] (15th Edition Revised, 2003). Thus, courts routinely interpret termination as used in §502(b)(6) as something other than termination as defined by nonbankruptcy law.

Further, when Congress intends the question of termination to be governed by nonbankruptcy law, it expressly says so. For example, § 365(c)(3) applies to a lease that "has been terminated under applicable nonbankruptcy law" and § 365(h)(1)(A)(i) applies when breach would allow a debtor-lessor "to treat such lease as terminated by virtue of … applicable nonbankruptcy law …." By contrast, § 502(b)(6) invokes termination generally, not by reference to nonbankruptcy law.

Finally, a bankruptcy definition of termination supports the purpose of § 502(b)(6) to limit large claims for prospective damages. *See Flanigan v. Samalex Trust* (*In re Flanigan*), 374 B.R. 568, 577-78 (Bankr. W.D. Pa. 2007). As the facts of this case demonstrate, a lessor can structure the terms of a lease such that even dispossession of a delinquent tenant does not effect a termination of the lease under nonbankruptcy law. Thus, if the Court applied a state law definition of termination, after a lessee has been dispossessed and the lessor has regained full benefit of the property, rents could conceivably continue to accrue for the remainder of the lease term or until the debtor files for bankruptcy and be deemed past due rents rather than prospective rents for purposes of § 502(b)(6).

Accordingly, the Court reaffirms its ruling that the Lease terminated for purposes of § 502(b)(6) on December 19, 2001, which is also the date from which the rent cap should be calculated. The Court will now consider the Objection with respect to the allowed amount of Jamestown's claim.

II. Application of § 502(b)(6)

The case law does not provide an easy or consistent framework for applying § 502(b)(6), especially when, as in this case, the lessor's claim includes rent and non-rent components that accrued both pre- and post-termination. The court in *Kupfer v. Salma* (*In re*

Kupfer), No. 14-cv-668, 2014 WL 4244019 (N.D. Cal. Aug. 26, 2014), noted that § 506(b)(6) incorporates "two distinct concepts." *Id.* at *3. "The claims cap *amounts* to the sum of unpaid rent and rent reserved, but it *applies* to the 'claim of a lessor for damages resulting from the termination of a lease of real property.'" *Id.* (quoting 11 U.S.C. § 502(b)(6)) (emphasis in original). As a result, the claim is subject to two tests—one to determine whether it is a claim resulting from termination of the lease and one to determine the cap amount and whether such damages are limited to rent or rent reserved or are more broadly allowable as damages.

In this case, Jamestown's claim broadly consists of two components: damages flowing from the pre-termination 2001 Judgment and damages flowing from the post-termination 2003 Judgment. The Trustee contends both components are limited to those amounts that constitute actual rents, effectively disallowing any amounts that represent late charges, attorney fees, interest, or other non-rent charges. This is apparently based on the language of § 502(b)(6), which limits the allowed claim to a fraction of rent reserved plus unpaid rents. The Trustee's position finds some support in *Smith v. Sprayberry Square Holdings, Inc.* (*In re Smith*), 249 B.R. 328 (Bankr. S.D. Ga. 2000). In *Smith*, the landlord terminated the lease on the petition date approximately 16 months after the debtor defaulted on the lease and more than one year after the debtor vacated the premises. *Id.* at 335. The court held that the plain language of § 502(b)(6)(B) limited prepetition damages to unpaid rents and those amounts that share the characteristics of rent; all other types of damages were disallowed. *Id.* at 336-37.

This Court disagrees with *Smith* to the extent that it fails to take into account the phrase "damages resulting from the termination of a lease …." *See In re MDC Sys., Inc.*,488 B.R. 74, 82 (Bankr. E.D. Pa. 2013) (as a threshold matter, "[t]he claim must be: (1) of a lessor (2) for damages arising from the ***termination*** of a lease, (3) of real property.") "If Congress had

intended an interpretation of § 502(b)(6) that would remove the modifier 'termination' from the statutory phrase 'damages resulting from termination of a lease,' Congress would have simply omitted the word 'termination.'" *In re Dronebarger*, No. 10-10889, 2011 WL 350479, at *13 (Bankr. W.D. Tex. Jan. 31, 2011) (emphasis in original).

In *Saddleback Valley Cmty. Church v. El Toro Materials Co.* (*In re El Toro Materials Co.*), 504 F.3d 978 (9th Cir. 2007), the court held that a landlord's tort claims for property damage against the debtor were not damages resulting from termination of the lease and were not, therefore, subject to the lease cap. *Id.* at 980-81. The purpose of § 502(b)(6) was to prevent landlords from asserting large rent claims that might otherwise deplete the estate, but not to limit other types of claims to which the landlord is entitled under nonbankruptcy law. *Id.* at 980.

> To limit [landlords'] recovery for collateral damages only to a portion of their lost rent would leave landlords in a materially worse position than other creditors. In contrast, capping rent claims but allowing uncapped claims for collateral damage to the rented premises will follow congressional intent by preventing a potentially overwhelming claim for lost rent from draining the estate, while putting landlords on equal footing with other creditors for their collateral claims.

Id. (footnote omitted). The court announced a test for applying § 502(b)(6): "Assuming all other conditions remain constant, would the landlord have the same claim against the tenant if the tenant were to assume the lease rather than rejecting it?" *Id.* at 981.

As the court in *Kupfer* noted, "*El Toro* did not purport to eliminate the possibility that non-rent damages can result from lease termination, nor did it remove non-rent lease termination damages from the section 502(b)(6) cap." 2014 WL 4244019, at *4. Instead, the court "narrowed the scope of the claims cap to damages which, while not necessarily 'rent,' are at least causally related to lease termination in the same way as lost rent." *Id. See also Cutler v.*

Lindsey (*In re Lindsey*), No. 96-2268, 1997 WL 705435, at *5 (4th Cir. Nov. 7, 1997) (unpublished) (§ 502(b)(6) "only limits those damages which would have been avoided but for termination of a lease."); *In re Atlantic Container Corp*, 133 B.R. 980, 987 (Bankr. N.D. Ill. 1991) (the phrase "damages resulting from the termination of a lease" in § 502(b)(6) suggests that the provision "is intended to limit only those damages which the lessor would have avoided but for the lease termination."); *In re Rock & Republic Enter., Inc.*, No. 10-11728, 2011 WL 2471000, *25 (Bankr. S.D.N.Y. June 20, 2011) (unpublished) (concluding that attorney fees and interest related to the landlord's prepetition lawsuit against the debtor were not damages related to termination of the lease and therefore were not disallowed or limited by § 502(b)(6)(B)); *In re MDC Sys., Inc.*, 488 B.R. at 96 (concluding that § 502(b)(6) "restrict[s] only the 'rent' component of a landlord's claim and not any other amounts that comprise the debt under applicable nonbankruptcy law").

As a result, in deciding which portions of Jamestown's claim are subject to the cap, it is appropriate to ask whether the damages resulted from termination of the Lease or whether they could have been avoided in the absence of termination. Because the 2001 Judgment represents rents and other costs due and owing and because the limitation in § 502(b)(6) imposes a connection to termination, the Court concludes that the 2001 Judgment amount is allowed in its entirety, including any post-judgment interest that accrued prepetition.

The Trustee contends that the claim for the 2001 Judgment should be reduced by amounts already paid by Debtor. The exact details of the payments made by Debtor are not in evidence. Rather, the Trustee cites to the August 12, 2002, affidavit of James B. Reaves filed in support of the motion for summary judgment in the second state court lawsuit. [Respondent's Ex. 6]. Paragraph 6 of the affidavit states: "[Debtor] has not paid any of the [2001] judgment

voluntarily. Jamestown has been forced to file numerous garnishment actions. Including post-judgment interest, approximately $75,000 remains unpaid on the $151,706.10 judgment." *Id.* at p.2. In Jamestown's first amended claim filed in 2007 [Claim 35-1], Jamestown asserts that it is owed $126,050.76 on account of the 2001 Judgment. This amount is calculated as follows: the judgment amount of $151,706.10 plus post-judgment interest of $58,405.87 less amounts recovered prepetition. Although the proof of claim does not specify the amounts recovered prepetition, a Judgment of $151,706.10 plus interest of $58,405.87 less remaining amount due of $126,050.76 indicates Jamestown has received payments of at least $84,061.21. Jamestown's second amended claim, filed after the October 6 Order was entered, does not include a credit for amounts paid and asserts that Jamestown is owed $206,220.54 on account of the 2001 Judgment which is comprised of the $151,706.10 judgment amount plus post judgment interest of $54,514.44.

This increase in the amount claimed on account of the 2001 Judgment is explained by Jamestown's argument that any payments received from Debtor are mitigation payments that reduce its total claim, rather than reducing its capped claim. However, the cases Jamestown relies on in making this argument address the situation where a landlord re-leases its property after the debtor has abandoned the property or been dispossessed. In that scenario, the payments received from the replacement tenant are deducted from the landlord's total claim rather than the capped claim. *Solow v. PPI Enter. (U.S.), Inc*. (*In re PPI Enter. (U.S.), Inc*)., 324 F.3d 197, 208 n.17 (3d Cir. 2003); *Fifth Ave. Jewelers. v. Great E. Mall* (*In re Fifth Ave. Jewelers*), 203 B.R. 372, 381 (Bankr. W.D. Pa. 1996).

Here, in contrast, the payments relate to the uncapped portion of the claim, that is, the 2001 Judgment portion of Jamestown's claim. Debtor's payments on account of the 2001

Judgment were made in partial satisfaction of a debt for rent and other breach costs due and owing as of termination of the Lease and not in mitigation of Jamestown's claim for prospective rent. Were the Court to accept Jamestown's argument, it would result in double-dipping or Jamestown being paid twice for amounts due under the 2001 Judgment. Thus, the allowed amount of Jamestown's claim for the 2001 Judgment must include a credit for the payments received on account of the 2001 Judgment and the amounts in excess of $126,050.76 will be disallowed.

Turning to the 2003 Judgment, all parts of the judgment, including post-judgment interest and attorney fees, consist of either prospective rents or damages awarded in an effort to collect prospective rents. In other words, the 2003 Judgment results entirely from termination of the Lease for purposes of § 502(b)(6). Although the 2003 Judgment may have preclusive effect as to the total amount of the claim, "the preclusive effect does not prevent this Court from limiting the amount of damages" that are allowable under § 502(b)(6). *Dronebarger*, 2011 WL 350479, at *5. "This is for the simple reason that the State Court did not have jurisdiction over the claims allowance process in bankruptcy and § 502(b)(6) was not and could not have been asserted or litigated by the parties in the State Court suit." *Id.; see also Fifth Ave. Jewelers*, 203 B.R. at 382. Therefore, the allowed portion of the 2003 Judgment and interest on the judgment will be limited to an amount equal to the applicable fraction of the rent reserved.

Under § 502(b)(6)(A), the allowed claim on account of the 2003 Judgment is limited to rent reserved by the lease for the greater of one year or 15% of the remaining lease term (not to exceed three years). This case raises the question of how to define the phrase "remaining lease term." In the calculation of its claim, Jamestown used a remaining lease term of 102 months from the January 2001 termination date. However, it is now known that Jamestown

sold the Property in October 2003 not subject to the Lease, which suggests there is no remaining lease term after October 2003. It makes no sense to allow Jamestown to calculate its rent reserved based on prospective rents for a time period after Jamestown sold the Property and any accompanying benefits in October 2003. As a result, Jamestown cannot now expect to include as part of its claim calculation an additional 81 months of prospective rents to which it no longer has any claim under nonbankruptcy law. *See Fifth Ave. Jewelers*, 203 B.R. at 380 (concluding that the lease does not reserve any rent following its termination). "The Court views this proposition as proper because it does not believe that Congress would have included in the cap a provision for damages that could not be recovered under pertinent state law." *Id.* In the absence of any evidence that Jamestown retained any rights in the Lease after the sale of the Property, the Court concludes that the remaining term of the Lease for purposes of § 502(b)(6)(A) did not extend past the October 2003 sale date, or 21 months from the termination date[2]. Because one year is greater than 15% of 21 months, Jamestown's allowed claim must be capped at the amount of rent reserved for one year.

Rent reserved is not defined by the Bankruptcy Code. However, the court in *Kuske v. McSheridan* (*In re McSheridan*), 184 B.R. 91 (BAP 9th Cir. 1995), set forth a three-part test for determining whether various types of damages constitute rent reserved:

> 1) The charge must: (a) be designated as "rent" or "additional rent" in the lease; or (b) be provided as the tenant's/lessee's obligation in the lease;
> 2) The charge must be related to the value of the property or the lease thereon; and

[2] The Court notes a split of authority on the method of calculating the 15% limit. Some courts calculate 15% of the remaining rent due under the lease; others calculate 15% of the number of months remaining under the lease. *In re Shane Co*., 464 B.R. 32, 39-40 (Bankr. D. Colo. 2012). Jamestown appears to have used a hybrid of the two methods. It first calculated 15% of the remaining months due under the lease as 15.3 months. It then determined that the 2003 Judgment covered a period of 19 months. It then determined at 15.3 months is 80.53% of the period covered by the 2003 Judgment. Finally, it multiplied the amount due under the Judgment for rent, operating expenses, late fees, and taxes by 80.53% to arrive at the capped amount. Although the Trustee objected to the amounts included in the cap, he did not object to the method employed to calculate the cap.

> 3) the charge must be properly classifiable as rent because it is a fixed, regular or period charge.

184 B.R. at 99-100. This test has been widely adopted, and will be applied in this case.[3]

Jamestown applied the rent cap to the portion of its 2003 Judgment that represented rent, operating expenses, late fees, and taxes. It then increased its allowed claim to include contract and post-judgment interest, attorney's fees awarded, and interest on the attorney's fees. However, as explained above, the Court concludes that all amounts due under the 2003 Judgment constitute damages that resulted from termination of the Lease, including late fees, interest, and attorney's fees. As such these amounts are subject the § 502(b)(6) cap, but because the late fees, interest, and attorney fees do not satisfy all the elements of the *McSheridan* test they do not constitute rent reserved and will be disallowed.

In contrast the monthly rent, operating expenses and taxes identified in the Reeves affidavit do satisfy the *McSheridan* test and constitute rent reserved within the meaning of 502(b)(6). The amount of rent reserved for the 19 month period from February 2001 through August 2002 is $1,438,653.78. [Respondent's Ex. 6 ¶16]. The monthly rent reserved is thus, $75,718.62, and the rent reserved for 12 months is $908,623.44. Consequently, Jamestown's allowed claim on account of the 2003 Judgment is capped at $908,623.44. Jamestown's claim on account of the 2001 Judgment is not capped but must be reduced by prepetition payments made on account of the 2001 Judgment. Thus, the 2001 Judgment portion of Jamestown's claim will be allowed in the amount of $126,050.76 for a total allowed claim in the amount of $1,034,674.20.

[3] Jamestown argues that in light of the *El Toro* decision, *McSheridan* is no longer good law. However, *El Toro* only overruled *McSheridan* to the extent it capped tort claims that arose independent of lease termination. 504 F.3d at 981.

CONCLUSION

In accordance with the reasons set forth herein, it is now

ORDERED that the Trustee's Objection is Sustained in Part and Claim number 12 is allowed as a general unsecured claim in the total amount of $1,034,674.20.

END OF ORDER

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